

Enrollment Period August 23, 2004 - December 13, 2004



Get KAPT.

Because higher
education shouldn't
be out of reach.

QUESTIONS?

1-888-919-KAPT

www.getKAPT.com

KAPT is a program
administered by the
Kentucky Higher Education
Assistance Authority

P.O. Box 798
Frankfort, KY 40602-0798



No taxpayer funds were used for the production or dissemination of these materials.

KHEAA Promotes Equal Opportunity M/F/D

KAPT

Kentucky's Affordable Prepaid Tuition



1-888-919-KAPT www.getKAPT.com



Enrollment Period

August 23, 2004 - December 13, 2004



Kentucky's Affordable Prepaid Tuition

Dear Kentucky Families:

Higher education has never been more important. In today's new economy, high-paying, high-tech jobs are usually reserved for graduates of college or another institution of higher education. At the same time, a college education has never been more expensive. Approximately every 10 years, the cost of higher education doubles.

KAPT, Kentucky's Affordable Prepaid Tuition, has been designed to make it easier for Kentucky families to afford a college education by guaranteeing the cost of tomorrow's tuition at lower prices today. What's more, the investments grow completely tax-free, ensuring that every dollar you save can be used for higher education expenses.

This booklet will help answer your questions about KAPT. If you have further questions about the program or would like more information or printed application materials, please call the toll-free number at 1-888-919-KAPT during our enrollment period. You can also access our web site, www.getKAPT.com, throughout the year.

In the meantime, please accept my hearty congratulations for taking an important step in securing an affordable postsecondary education. By opening a KAPT account, you join the ranks of a growing number of citizens who know that attaining a diploma without debt is well within reach.

Very truly yours,

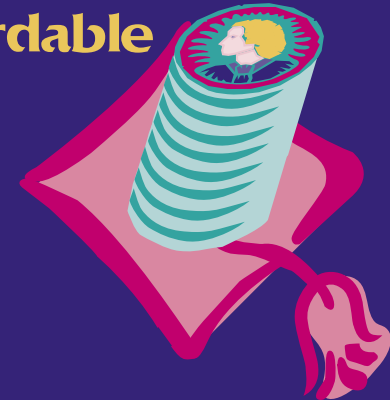
Jonathan Miller
State Treasurer
KAPT Founder

Remember KAPT. . .

Keeps
Options Open



is **A**ffordable



is **P**ortable



is **T**ax Free

TABLE OF CONTENTS

Kentucky's Affordable Prepaid Tuition



At a Glance

Page

- KAPTivating Facts 2
- How It All Began 3



Frequently Asked Questions

- How KAPT Works 4
- Eligibility and Use of Benefits 7
- A Guide To Kentucky Public Colleges, Universities, and
Technical Colleges Eligible for KAPT's Guarantee 10
- Flexibility 12
- KESPT and Other Education Savings Plans 14
- Payments and Pricing 15
- Refunds 18
- Tax Issues 19



Application Materials

- Master Agreement 20
- Disclosure Statement..... 32
- Booklet Inserts
 - Application
 - Automatic Bank Draft Form
 - Fee Schedule
 - Participation Prices
 - Return Envelope

KAPTivating Facts about Kentucky's Affordable Prepaid Tuition

Keeps Options Open

KAPT purchasers can choose from three different plans:

1. **The Value Plan** guarantees tuition at most of Kentucky's community and technical colleges.
2. **The Standard Plan** guarantees tuition at Kentucky's 4-year public universities.
3. **The Premium Plan** aims to cover the average price of tuition at Kentucky's private colleges and universities.

All three KAPT plans can be used at any qualified institution of higher education, public or private, anywhere in the country. Purchasers can also change plans any time a need arises until the beneficiary begins to use benefits.

A refund is issued with no penalties if a student receives a scholarship, dies, or becomes disabled and cannot attend school.

Affordable

KAPT lets families cap college inflation rates by offering the cost of tomorrow's tuition at lower prices today.

Parents, grandparents, or other account holders can prepay tuition in one lump sum or in manageable monthly payments over many years until the student begins school.

Tax Free

KAPT investment earnings are exempt from state and federal income taxes.* Excess funds can be used tax-free towards other qualified higher education expenses such as room, board, and books.

Portable

Once an account is paid in full and your beneficiary enrolls in college, KAPT guarantees payment of tuition and mandatory fees at any public college or university in Kentucky in accordance with the tuition purchased.

Benefits can also be used at private Kentucky colleges and universities as well as colleges and universities nationwide. Benefits can be transferred among siblings, cousins, and other eligible family members with no penalties.

HOW IT ALL BEGAN

The history of Kentucky's Affordable Prepaid Tuition (KAPT) is a bright example of how bipartisanship and forward-looking policy development can bring outstanding government programs to the public.

In 1999, Jonathan Miller (D-Lexington) built his campaign for Kentucky State Treasurer around the theme of bringing to Kentucky a prepaid college tuition savings plan. Nineteen other states already had these plans, which help make it easier for families to afford college by guaranteeing the cost of tomorrow's tuition at lower prices today. Upon his election, Treasurer Miller petitioned the Kentucky state legislature during its regular session in 2000 to pass enabling legislation. In January, State Representative Rocky Adkins (D-Sandy Hook) introduced House Bill 180 to bring the state a prepaid tuition plan. Under Rep. Adkins' leadership, more than 60 members of the 100-member House of Representatives signed on as original co-sponsors. House Bill 180 passed through two House committees and the House floor, all with unanimous votes.

After reaching the Senate, Senate Education Committee Chairman Lindy Casebier (R-Louisville) spearheaded the effort to pass House Bill 180, and was helped significantly by Senator Bob Jackson (D-Murray). Again, the legislation passed two Senate committees and the Senate floor without a single negative vote.

On March 28, 2000, the legislation was signed into law by Governor Paul Patton (D-Pikeville), whose commitment to educating Kentucky's young people was the hallmark of his administration.

KAPT—already a good program—became a much better one after legislation was passed by the U.S. Congress in 2001. The Setting Aside for a Valuable Education (SAVE) Act, which was introduced in January 2001 by Senator Mitch McConnell (R-Louisville), and strongly supported by then-Congressman (and now Kentucky Governor) Ernie Fletcher, ensured that KAPT investments would be completely tax free. When the SAVE Act was incorporated into

broader tax-cut legislation signed by President George W. Bush (R) in May 2001, KAPT became an even more attractive investment for Kentucky families.



State Treasurer Jonathan Miller and Senator Mitch McConnell launch KAPT's first enrollment period in 2001.

*The law allowing federal tax-free withdrawals is set to expire on December 31, 2010. Congress may or may not extend the law beyond this date.

HOW KAPT WORKS: THE KAPT GUARANTEE



How does KAPT work?

KAPT guarantees the price of tomorrow's tuition at lower prices today. There are three plans.

THE VALUE PLAN—Guarantees the price of in-state tuition and mandatory fees at almost every Kentucky Community and Technical College System (KCTCS) college. Participants prepay the cost of KCTCS tuition through a lump-sum or monthly payment plan. Tomorrow's KCTCS tuition price for full-time enrollment will be guaranteed up to 16 hours per semester. If the child attends a more expensive school that is not in the Value Plan, the family will have to make up the difference.

THE STANDARD PLAN—Guarantees the price of in-state undergraduate tuition and mandatory fees at Kentucky's eight public universities. Participants prepay the cost of tuition at Kentucky's most expensive public university through a lump-sum or monthly payment plan. This plan will guarantee tomorrow's tuition price for full-time enrollment, up to 16 hours per semester, at the state's most expensive public university. If a child attends a less expensive school—for instance, a community college or one of the less expensive four-year regional universities—the difference can be applied to qualified higher education expenses such as room, board, and books. If the child attends a more expensive school not in the Standard Plan, the family will have to make up the difference.

THE PREMIUM PLAN—Aims to cover the average price of tuition at Kentucky's private colleges and universities. Participants prepay the weighted average cost of tuition at Kentucky's private colleges and universities in the Association of Independent Kentucky Colleges and Universities. While no particular school's tuition is guaranteed, your investment grows at the same rate as the University of Kentucky's tuition. This plan should cover tuition at many of the state's private schools and all of Kentucky's public colleges and universities. Depending on tuition rates, any money left over can cover qualified educational expenses such as books, room, and board.



What is KAPT's guarantee?

Kentucky law provides that your KAPT contract constitutes an irrevocable pledge and guarantee by the Fund to pay tuition of a qualified beneficiary in accordance with your purchased tuition plan and your Master Agreement. You should also be aware of the following. First, payment of the tuition guarantee is contingent upon the Fund consistently meeting its investment targets. Your

KAPT contract is not backed by the full faith and credit of the Commonwealth of Kentucky; this means that the General Fund of the Commonwealth is not obligated to fund any KAPT tuition liabilities. However, under current law, 75 percent of the State Treasurer's Unclaimed Property Fund (currently \$80 million), may be used to fund any KAPT shortfalls.



How can KAPT make this guarantee?

The KAPT Trust Fund, into which payments are made, seeks to produce a return that is equal or greater than college tuition inflation. Should the investments produce a smaller return, the Trust Fund is backed by 75 percent of the State Treasurer's Unclaimed Property Fund. While this legislative guarantee could be removed by the Kentucky General Assembly, such an action would affect only subsequent contracts—not contracts entered into during the fall 2004 enrollment period or prior enrollment periods. The Kentucky Constitution prohibits the legislature from impairing contracts made between the state and any individual, such as the KAPT Master Contract Agreement.

For additional information, please visit KAPT's website, www.getKAPT.com, to download KAPT's latest financial statements, actuarial report, and investment performance.



Is KAPT guaranteed by the Commonwealth of Kentucky?

KAPT does not have a constitutional full faith and credit backing of the Commonwealth of Kentucky, meaning the Kentucky General Fund is not mandated to fund KAPT in the event the KAPT Trust Fund and the State Treasurer's Unclaimed Property Fund are not sufficient to pay KAPT contract obligations. However, KAPT does have a statutory guarantee, and in the unlikely event KAPT experiences a shortfall, the Kentucky General Assembly could authorize additional funding.

Please keep in mind that KAPT's guarantee only becomes effective upon your full payment of all contractual obligations and enrollment by your KAPT beneficiary. Entering into a KAPT contract establishes a legal obligation of the Fund to pay tuition only if you meet those requirements.



Is there an individual account set up for my money?

The program is not an individual savings account. It is a trust fund that combines the contributions of all participants in order to maximize benefits from institutional investment activities. KAPT does maintain separate accounting records for each participant and his or her contributions for the purpose of calculating refunds, reporting to the Internal Revenue Service, and administering payments when a

student enters college. Purchasers will receive annual account statements reflecting contributions, distributions, and other financial data relating to their KAPT contract. You can also access your account information online at www.getKAPT.com.



How is KAPT different from traditional private investments?

The value of your KAPT account is strictly tied to increases in college tuition and does not depend on the whims of the stock market. Second, KAPT investment earnings are exempt from state and federal taxes, unlike many other types of investments.



Who manages the money I pay into KAPT?

The Fund is governed by the KAPT Board of Directors whose members include state officials and other Kentucky citizens with a range of financial, business, and legal expertise. KAPT investments are professionally managed by an independent investment manager under the oversight of the Board. Funds are managed consistent with prudent investment strategies, which are defined and monitored by a nationally-recognized investment consulting firm.

The Kentucky Higher Education Assistance Authority, the state agency that administers loan, grant, scholarship, work-study, and savings programs for higher education, administers KAPT's daily operations under the governance of the KAPT Board of Directors.



How do I purchase a contract?

To purchase a contract, complete the application inserted in this booklet and return it along with your non-refundable \$50 application fee by the deadline marked on the application form or visit www.getkapt.com to complete an on-line application. Children under one year old can be enrolled year round. After paying the \$50 application fee for their first application, families receive a discounted application fee of \$25 for each additional application submitted in the fall 2004 enrollment period.



Will I receive an official document outlining the terms and conditions of my KAPT contract?

Included in this enrollment booklet and at www.getKAPT.com is a copy of the Fall 2004 Master Agreement and Disclosure Statement. KAPT encourages you to read these documents before submitting an application. After your application is processed, you will receive a Welcome Kit containing a Terms and Conditions of Payment and Purchase document. Your Terms and Conditions of Payment and Purchase, the Master Agreement, KAPT regulations, applicable

state and federal law, and your application make up your KAPT contract.



Will KAPT be offered again in the future?

KAPT may or may not have future enrollment periods. Factors, including the actuarial status of the fund, tuition increases, and investment returns, will be reviewed annually by the KAPT Board of Directors in making decisions about future enrollments. KAPT contracts already purchased will not be affected by future enrollment periods.

ELIGIBILITY AND USE OF BENEFITS



Who is eligible to open a KAPT account?

Anyone interested in the welfare and education of a beneficiary (parents, grandparents, friends, loved ones, or even trust foundations and corporate entities) can open a KAPT account. They can contribute to KAPT whether they live in Kentucky or in another state.



May two people jointly purchase a contract?

Although many people may contribute to a single KAPT account, only one purchaser is allowed. That person is the owner of the contract, but the purchaser can also appoint a successor-in-interest on the application form who can receive contract information and assume contract rights upon the death of the purchaser.



Who is eligible to receive benefits from a KAPT account?

There are no age limits on who can benefit from KAPT. Any adult or child who is at least two years from using contract benefits is eligible to be a KAPT beneficiary, as long as he or she is a Kentucky resident at the time the application is signed or intends to attend college in Kentucky.



Once I open a KAPT account, how long is it before the beneficiary can begin using benefits?

KAPT requires a two-year waiting period before benefits can be used, even if the account is paid in full initially with a lump sum. Payment of benefits cannot begin prior to the second anniversary of the first payment due date of the agreement. Accounts must be paid in full before benefits can be used.



My child is a junior in high school this year. Does this mean I can't open a KAPT account?

Although the two-year waiting period still applies, this does not prevent you from opening a KAPT account. Persons who open accounts during the fall 2004 enrollment won't be able to use KAPT benefits until the fall of 2007. Therefore, your high school junior would not be able to use KAPT benefits until her sophomore year in college. But you could still purchase tuition for her sophomore, junior, and senior years, for example. Keep in mind that all accounts must be paid in full before use of the benefits can begin.



Where can the money be used?

Funds can be used at any institution of higher education public or private, anywhere in the country, that is accredited by the U.S. Department of Education. Because KAPT is designed to support lifelong learning, benefits may also be applied towards graduate schools. Payments for tuition and mandatory fees at graduate schools will not exceed the undergraduate level benefits as described in the KAPT guarantee.



What expenses can be paid with KAPT funds?

Qualified higher education expenses are tuition and fees, books, supplies, and equipment required for enrollment and room and board if the beneficiary is enrolled at least half-time.



What "mandatory fees" does KAPT's guarantee cover?

Mandatory fees are those fees required as a condition of enrollment incurred by all students at an eligible educational institution.



Does the purchase of a KAPT contract guarantee student admission to a college or university or in-state tuition rates?

No. Students must meet the admission requirements of the school they wish to attend. The determination by a particular state institution as to whether a student is eligible for in-state tuition rates is completely independent from the ownership of a KAPT contract.



When my beneficiary attends college, how will KAPT make payments?

In general, KAPT will send funds directly to the higher education institution at the beginning of each semester at the direction of the account purchaser. When

the projected college entrance year is reached, KAPT will provide information and forms regarding tuition payments. For more information on the KAPT payout process, see the Using Benefits section at www.getKAPT.com.



How will KAPT determine the amount of benefits available?

Once your beneficiary reaches the projected college entrance year, a payout value for your contract will be calculated each academic year when institutions set their tuition and fees. The payout value will depend on the type of KAPT plan you have and the number of benefit hours on your account. Each KAPT contract year you purchase is the equivalent of 32 KAPT benefit hours. Depending on the number of contract years purchased, you could have up to 160 benefit hours available when your beneficiary begins using benefits (five contract years of tuition).

For example, the Standard Plan payout value is equal to the highest-priced Kentucky public university tuition and mandatory fees. If the University of Kentucky has the highest-priced tuition and mandatory fees for the year at \$5,000 per semester, the payout value for one contract year of the Standard Plan for that academic year will be \$10,000 or \$312.50 per KAPT benefit hour. If you own four years of the Standard Plan, your one-year payout value will be \$10,000 and your full account payout value will be \$40,000 at that time.

For more information on using KAPT benefits, see the Using Benefits section at www.getKAPT.com.



How will KAPT affect a student's eligibility for financial aid?

Any investments or savings are likely to affect financial aid eligibility. In addition, there is uncertainty as to how much and what type of financial aid will be available to families in future years. For federal need-based financial aid, the receipt of KAPT contract benefits may affect a beneficiary's eligibility for some amount of financial aid as the contract benefits are currently treated as a financial resource of the beneficiary. Your contract benefits are not included in determining the amount of Kentucky state student aid your beneficiary will receive, and your contract benefits should not affect the beneficiary's receipt of merit-based financial aid such as academic or athletic scholarships. The best resource for more detailed information is the financial aid office of your local college or university.

A GUIDE TO PUBLIC COLLEGES, UNIVERSITIES, AND TECHNICAL COLLEGES ELIGIBLE FOR KAPT'S GUARANTEE

The following is a list of Kentucky public colleges, universities, and technical colleges that are eligible for the KAPT guarantees provided under the Value and Standard Plans. Benefits from Kentucky's Affordable Prepaid Tuition can be used at ANY qualified institution of higher education, public or private, anywhere in the country.

THE VALUE PLAN GUARANTEE

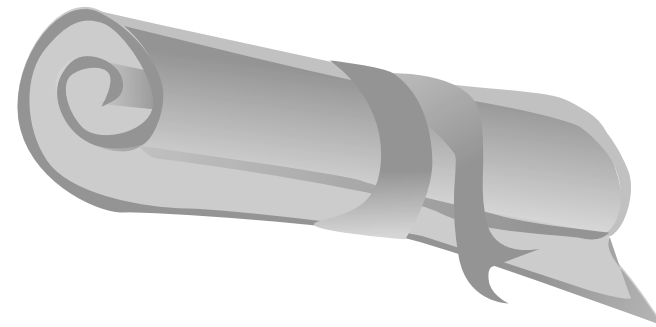
Kentucky Two-Year Community and Technical Colleges

KAPT's Value Plan includes a guarantee of tuition at the following Kentucky Community and Technical College System (KCTCS) institutions:*

Ashland Community and Technical College
Big Sandy Community and Technical College
Bowling Green Technical College
Central Kentucky Technical College
Elizabethtown Community and Technical College
Gateway Community and Technical College
Hazard Community and Technical College
Henderson Community College
Hopkinsville Community College
Jefferson Community and Technical College
Madisonville Community College
Maysville Community and Technical College
Owensboro Community and Technical College
Somerset Community College
Southeast Kentucky Community and Technical College
West Kentucky Community and Technical College

NOTE: *Lexington Community College (LCC) is not included in the Value Plan guarantee because LCC has a different tuition and fees pricing structure from the other KCTCS institutions. Value Plan contract benefits can be used at LCC or any other qualified higher education institution.*

**The Value Plan payout value is based on a maximum of 16 hours per semester at KCTCS.*



THE STANDARD PLAN GUARANTEE

Kentucky Four-Year Public Universities

KAPT's Standard Plan includes a guarantee of in-state undergraduate tuition at the following schools:*

EVERY community and technical college listed in the Value Plan
Eastern Kentucky University
Kentucky State University
Lexington Community College (two-year public college)
Morehead State University
Murray State University
Northern Kentucky University
University of Kentucky
University of Louisville
Western Kentucky University

**The Standard Plan payout value is based on a maximum of 16 hours per semester at the highest-priced Kentucky public university.*



REMEMBER...

**ALL THREE KAPT PLANS CAN BE USED AT
ANY QUALIFIED INSTITUTION
OF HIGHER EDUCATION,
PUBLIC OR PRIVATE,
ANYWHERE IN THE COUNTRY.**

FLEXIBILITY



What if I don't know which school my beneficiary will want to attend?

That's not a problem. If, for example, you pay for the Standard Plan in anticipation that the student will attend a four-year public university, but the student later decides to attend a Kentucky community college, the difference between the tuition of the four-year university and the tuition at the community college can be used to pay for books and other qualified higher education expenses.



Can more than one account be opened for the same beneficiary?

Yes. For example, if you anticipate your beneficiary may want to attend a community college and a public university, you may want to open a two-year Value Plan and a two-year Standard Plan. Also, other family members and friends can open KAPT accounts for your beneficiary as long as the total years of tuition purchased does not exceed the five-year maximum.



What if a student decides to attend a higher education institution that is not included in the tuition plan purchased?

The value of your tuition plan can be used at any qualified higher education institution in the country and abroad. If the tuition is more expensive than the contract value, the family will have to make up the difference.



What if a student decides to attend an out-of-state school?

The student can still use KAPT benefits. KAPT will pay the value of the tuition purchased under a purchaser's tuition plan, and if the out-of-state tuition is more expensive than those rates, the family will have to make up the difference through other means. Remember, KAPT benefits can be applied to any qualified institution of higher education, public or private, anywhere in the country.



What happens if I move out of state?

Movement out of state will not affect your KAPT account and will not affect the value of your tuition plan. If a student attends a Kentucky public college or university as an out-of-state student, and the out-of-state tuition charges exceed the value of the plan, the student will be responsible for the difference.



Are transfers among different types of KAPT tuition plans permitted?

Yes, until the beneficiary begins using benefits. Depending on the change in plans, your contract cost may increase or decrease.



Are transfers among different types of schools permitted after a student enrolls?

Yes. Transfers among colleges and universities are permitted, and any unused benefits under the contract can be used at the new college or university.



If I cancel my contract, may I get back into the program at a later date at the same price?

No, but anyone may re-enter the program during future enrollment periods by purchasing a new contract. Costs will likely be higher at the time of re-entry, so it is advantageous to remain in KAPT after a contract is established.



What if I simply can no longer afford to make payments into KAPT?

You can downgrade your tuition plan to a less expensive plan or you can choose to cover a fewer number of tuition years. This would result in either a lower payment amount or—if the payments already made by you are sufficient to cover the price of the downgraded plan—a paid-in-full tuition plan contract.



How many years of tuition can I purchase?

A total of five tuition years among the three KAPT plans may be purchased for one beneficiary by the same purchaser or different purchasers. Only two years of tuition may be purchased under the Value Plan for the same beneficiary.



Once I open a KAPT account, can I purchase additional years of tuition in the future?

Yes. You can buy additional years of tuition, up to the five-year maximum, during future enrollment periods by purchasing a new contract at the costs at that time. You may not add additional years to your current contract.



Can the purchaser of my account be changed?

The purchaser may be changed in certain circumstances such as death, disability, or divorce.



Can I change the beneficiary on my account?

Yes, as long as the new beneficiary is an eligible member of the family of the current beneficiary.

KESPT AND OTHER EDUCATION SAVINGS PLANS



How is KAPT different from Kentucky's Section 529 savings program?

The **Kentucky Education Savings Plan Trust (KESPT)** is Kentucky's qualified state tuition "savings" program under Section 529 of the Internal Revenue Code and is also administered by the Kentucky Higher Education Assistance Authority. KESPT offers three investment options, and there is no guarantee that account savings will cover higher education expenses. Savings in KESPT can be used for the full-range of college expenses (tuition and fees, room, board, books, and supplies). KAPT, by contrast, guarantees the future payment of tuition in the Value and Standard Plans. Different families have different needs—some like the flexibility of the savings program; others, the discipline and guarantee of KAPT. KESPT and KAPT should be considered complementary because they help families cover the full range of higher education costs. That's why numerous other states have both a prepaid and a savings option in place. Individuals may choose to participate in either KAPT or KESPT, or both. To request more information about KESPT, call 1-877-KY TRUST (598-7878) or visit www.kysaves.com.



Can I transfer funds to KAPT from KESPT or other Qualified Tuition Programs?

Yes. Funds may be transferred once per year without changing beneficiaries. Funds may be transferred to an account with a different beneficiary if the new beneficiary is an eligible member of the family of the current beneficiary. Call 1-888-919-KAPT and press option 2 to request a KAPT rollover form.



Can I transfer funds from KAPT to KESPT or other Qualified Tuition Programs?

Yes. Funds may be transferred once per year without changing beneficiaries. Funds may be transferred to an account with a different beneficiary if the new beneficiary is an eligible member of the family of the current beneficiary. Partial transfers from

KAPT are not allowed. Transfer requests should be made through the program to which you are transferring funds.



Can I transfer funds to KAPT from Coverdell Education Savings Accounts or U.S. Savings Bonds?

Yes. Funds may be transferred from Coverdell Education Savings Accounts (formerly known as "Education IRAs") and proceeds from certain qualified U.S. Savings Bonds. Call 1-888-919-KAPT and press option 2 to request a KAPT rollover form. Please consult your tax advisor regarding eligible rollovers from these types of assets.

PAYMENTS AND PRICING



What payment plans are available?

Purchasers can choose to make payments in the following ways:

- By a single lump sum
- By monthly payments over three, five, or seven years
- By a down payment plus monthly payments over three, five, or seven years
- By monthly payments until the beneficiary's projected year of enrollment.



How are plan prices determined?

Prices are based on tuition and fee rates at the Kentucky institution(s) specific to the guarantee of the tuition plan. In addition, an actuarial analysis is applied that reflects the risk associated with predicting future tuition and mandatory fee inflation, investment returns, and administrative costs.



Why is the total of the monthly payments higher than the lump-sum purchase price?

Monthly payments include an interest component to take into account the fact that the full contract purchase price is not available for immediate investment on your behalf. The fall 2004 enrollment annual investment premium included in the monthly installment prices is 7.25 percent. Purchasers signing up in future years may have installments that reflect a different rate, determined annually with new pricing by the Fund's actuaries. However, once you sign up, your contract price will not change.



Can I make a different down payment amount than the amounts listed and get a different payment amount?

If you make a down payment of \$6,000 or more, you may request a payment recalculation. To do so, select a payment schedule of either 3 years monthly, 5 years monthly, or 7 years monthly on the application. Do not select an option with a down payment. You must submit a signed written request for the recalculation along with the full down payment before the recalculation will be done.



Can I request a payment schedule different from those listed?

No.



How do I make payments?

You may make monthly payments by mail with a KAPT coupon book or by automatic deductions from your bank account. After your application has been processed, KAPT will send you payment instructions.



May I make KAPT payments through payroll deduction?

You will need to ask your employer if payroll deduction for KAPT is available where you work. Currently, payroll deduction is available in many government agencies and some large and small private companies. If your employer is not participating, visit www.getKAPT.com or have your payroll officer call KAPT for more information. Note that contributions to KAPT are made with after-tax dollars, not pre-tax dollars, regardless of the method of payment.



When are payments due?

All payments—lump sums, down payments, and first monthly payments—will be due on February 1, 2005, for purchasers who enroll during the fall 2004 enrollment period.



How long can I make payments?

You can make payments from now until your beneficiary's projected college entrance year by choosing the extended monthly payment option. The projected college entrance year you list on your application will determine your length of payment under the extended monthly payment option. Find your beneficiary's projected entrance year on the enclosed pricing sheet under Extended Monthly Payment Option to determine your payment amount under this option. Please

note that your account must be paid in full before July 1 of the projected college entrance year. Therefore, the 3-year payment option is only available if your beneficiary has a projected college entrance year of 2008 or higher, the 5-year payment option is only available if the college entrance year is 2010 or higher, and the 7-year payment option is only available if the college entrance year is 2012 or higher.



Can I pay off my account early?

Yes. You can call 1-888-919-KAPT and press option 2 to request a payoff amount at any time.



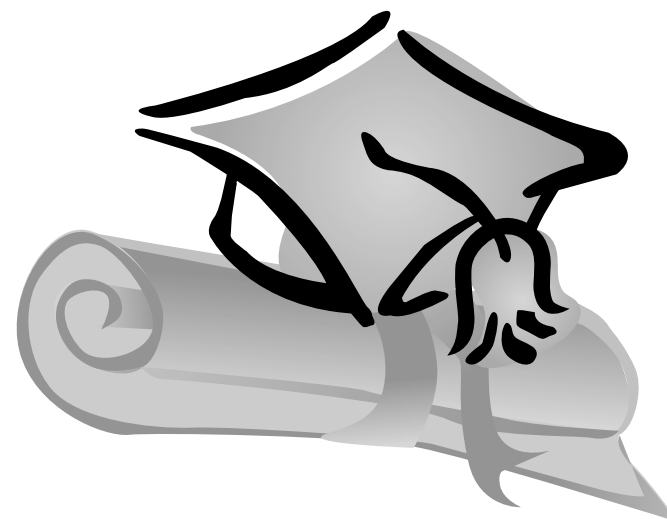
Can I change my payment plan?

Yes. You may submit a request in writing to change your payment plan at any time. A plan change fee will apply. Keep in mind your account must be paid in full before July 1 of the projected college entrance year.



What administrative fees will I have to pay?

A list of KAPT administrative fees are enclosed in this booklet and are available on the KAPT website, www.getKAPT.com.



REFUNDS



What if the student decides not to go to college?

For a small fee, KAPT contract benefits may be transferred to a member of the family of the beneficiary. If the new beneficiary is an older family member, benefits may be transferred as long as the plan will be paid in full by the new maturity year. Otherwise, a transfer of benefits to an older qualified family member may require additional payments.

Alternatively, a purchaser may want to retain the contract because a student can use the benefits indefinitely after the projected college entrance year.

A final option is to cancel all of the contract. See information below regarding cancellations.



What happens if I cancel my KAPT contract?

A purchaser may cancel a contract at any time.

If you cancel before July 1 of the projected college entrance year, you will receive a refund of payments made minus administrative and cancellation fees.

If you cancel on or after July 1 of the projected college entrance year, you will receive the tuition payout value of the account at that time minus administrative and cancellation fees and any benefits already used. Earnings that are refunded will be subject to federal and state income taxes and a 10 percent federal tax penalty.

If you cancel due to the death or permanent disability of the beneficiary, you will not be charged the cancellation fee or the 10 percent federal tax penalty. Earnings that are refunded will be subject to federal income taxes.



What if my beneficiary receives a scholarship?

If your beneficiary receives a scholarship for qualified higher education expenses, you may request a refund of your account up to the amount of the scholarship without being charged the cancellation fee or the 10 percent federal tax penalty. Earnings that are refunded due to scholarship will be subject to federal income taxes. Keep in mind that KAPT funds can be used for all qualified higher education expenses, so if your beneficiary receives a scholarship that covers tuition, your KAPT funds could still be used for other expenses like room, board, books, and supplies or graduate school.

TAX ISSUES



What are KAPT's tax advantages?

KAPT offers significant tax advantages. Earnings on your KAPT account are tax free at both a state and federal level when used for qualified higher education expenses.

Please note that the law allowing federal tax-free withdrawals is set to expire on December 31, 2010. Congress may or may not extend the law beyond this date. If the law is not extended, earnings that are used for qualified higher education expenses after 2010 will be taxable to the beneficiary at the beneficiary's tax rate.



Is there a tax deduction for KAPT contributions?

Contributions to KAPT are currently not eligible for a federal or Kentucky state tax deduction. Also, contributions to KAPT are made with after-tax dollars, not pre-tax dollars. Please consult your tax advisor for personal tax questions.



Can I deposit UGMA or UTMA funds in a KAPT account?

KAPT allows custodians for minors under the Uniform Gifts to Minors Act or Uniform Transfers to Minors Act (UGMA/UTMA) to open KAPT accounts. The accounts are subject to certain restrictions, which are described in the Master Agreement. Custodians should consult a tax advisor about the consequences of opening and holding KAPT accounts, as well as legal counsel regarding their rights and responsibilities as custodians. Please call 888-919-KAPT and press option 1 for instructions on completing a KAPT application for a UGMA/UTMA account.



What are the gift tax implications for a KAPT account holder?

Contributions to KAPT are considered a completed gift for gift tax purposes. No federal gift tax would be imposed on a purchaser for gifts to a beneficiary which do not exceed the annual gift tax exclusion amount (currently \$11,000). If an account holder makes up to \$55,000 in contributions in a single year, the contributions can be treated as having been made ratably over five years. As with any personal tax questions, it is important to consult your tax advisor.

MASTER AGREEMENT

FOR FALL 2004 ENROLLMENT PERIOD
AUGUST 23, 2004, TO DECEMBER 13, 2004

ARTICLE I **INTRODUCTION**

This Master Agreement (the “Agreement”), as amended from time to time, constitutes the basic terms and conditions of the Prepaid Tuition Contract entered into by the Purchaser and the Commonwealth Postsecondary Education Prepaid Tuition Trust Fund (a/k/a Kentucky’s Affordable Prepaid Tuition or “KAPT”), established by the Commonwealth of Kentucky (the “Commonwealth”) State Legislature and governed pursuant to KRS 164A.700-709 for the provision of prepaid postsecondary tuition benefits.

KAPT is an instrumentality of the Commonwealth governed by the Board and administered by the Kentucky Higher Education Assistance Authority (KHEAA).

This Agreement is issued in order to obtain federal income tax benefits under Internal Revenue Code of 1986, as amended (“Code”) Section 529 (26 U.S.C. 529); and this Agreement shall be construed, interpreted, and enforced, and all rights and obligations hereunder shall be administered to comply with 26 U.S.C. 529 and regulations issued thereunder.

ARTICLE II **DEFINITIONS**

For purposes of this Agreement, the following terms shall be defined as follows:

2.01 “Academic Year” means the time period specified by each Eligible Educational Institution.

2.02 “Board” means the Board of Directors of the Commonwealth Postsecondary Education Prepaid Tuition Trust Fund.

2.03 “Eligible Educational Institution” means an institution defined in Code Section 529.

2.04 “Full-Time Enrollment” means a maximum of 16 semester hours or the equivalent under a trimester or quarter system at an Eligible Educational Institution for purposes of determining the Value of a Prepaid Tuition Account.

2.05 “Fund” means the Prepaid Tuition Payment Fund created in KRS 164A.701 and known as the “Commonwealth Postsecondary Education Prepaid Trust Fund.”

2.06 “KAPT Regulations” means Kentucky Administrative Regulations issued by KAPT, as may be amended from time to time consistent with the provisions of Section 10.08 hereof.

2.07 “Mandatory Fees” means fees required as a condition of enrollment incurred by all students at an Eligible Educational Institution for purposes of determining the Value of a Prepaid Tuition Account.

2.08 “Office” means the Tuition Account Program Office in KHEAA that is responsible for administering Prepaid Tuition Accounts.

2.09 “Prepaid Tuition” means the amount of tuition estimated by the Board for the Tuition Plan under the Prepaid Tuition Contract.

2.10 “Prepaid Tuition Account” means the account for a Qualified Beneficiary as specified in this Agreement.

2.11 “Prepaid Tuition Contract” means this Agreement entered into (whether electronically or by Purchaser’s written application) by the Board and the Purchaser for the purchase of Prepaid Tuition for a Qualified Beneficiary to attend an Eligible Educational Institution, including without limitation, the terms and provisions of KAPT Regulations; operating procedures and policies adopted by the Board; and KRS 164A.700-709 and KRS 393.015, as may be amended from time to time. In the event of any amendments to KAPT Regulations, Code Section 529, or state statute, this Agreement shall be amended consistent with any such changes, with retroactive effect or otherwise.

2.12 “Projected Enrollment Date” means the estimated date that the Qualified Beneficiary shall be enrolled to attend an Eligible Educational Institution.

2.13 “Purchaser” means a person, corporation, association, partnership, or other legal entity who enters into this Agreement.

2.14 “Qualified Beneficiary” means (i) any Kentucky resident designated as beneficiary at the time a Purchaser enters into this Agreement; (ii) any non-resident designated at the time a Purchaser enters into this Agreement who intends to attend an Eligible Educational Institution in Kentucky; (iii) the new beneficiary, in the case of a change of beneficiaries under KRS 164A.707; or (iv) the individual receiving a scholarship in the case of a Prepaid Tuition

Contract purchased by a state or local government or agency or instrumentality thereof or an organization described in 26 U.S.C. Section 501(c)(3), and exempt from federal income taxation pursuant to 26 U.S.C. Section 501(a) as part of a scholarship program offered by the government entity or the organization.

2.15 “Qualified Postsecondary Education Expenses” means (i) tuition, fees, books, supplies, and equipment required for enrollment or attendance of a Qualified Beneficiary at an Eligible Educational Institution; (ii) expenses for special needs services in the case of a special-needs beneficiary which are incurred in connection with such enrollment or attendance; and (iii) room and board if the Qualified Beneficiary is enrolled at least half-time.

2.16 “Tuition” means the actual charges and all mandatory fees required as a condition of full-time enrollment in an undergraduate program for an Academic Year for a Qualified Beneficiary to attend an Eligible Educational Institution.

2.17 “Tuition Plan” means the options offered by KAPT for payment of Tuition at selected Eligible Educational Institutions. For the Fall 2004 enrollment period, there are three Tuition Plans: Value, Standard, and Premium.

2.18 “Value of a Prepaid Tuition Account” means the amount which the Fund is obligated to pay for Tuition for an academic period based on full payment of the Purchaser’s Tuition Plan; except, under a Tuition Plan for private colleges and universities, Tuition shall be calculated based on the same percentage that University of Kentucky tuition is increased from the year the Agreement is purchased to the year of payment. For Value and Standard Plans, the Value of a Prepaid Tuition Account shall be the cost of tuition not to exceed 16 semester hours at the institution applicable to the plan selected.

Capitalized terms used herein not otherwise defined in this Article II shall have such meaning as defined under KRS 164A.700-709 or KAPT Regulations, as applicable.

ARTICLE III ELIGIBILITY AND APPLICATION

3.01 Application and Terms of Purchase. This Agreement shall be entered into by the Purchaser for the provision of Prepaid Tuition for the benefit of a Qualified Beneficiary selected by the Purchaser in exchange for the payments made by Purchaser to the Fund, and its terms and provisions shall incorporate the Purchaser’s Application and Terms and Conditions of Payment and Purchase. The Purchaser understands and agrees that provision of benefits under this Agreement shall be made only upon receipt by KAPT of all payments

required under this Agreement, including such amounts as identified on the Purchaser’s Terms and Conditions of Payment and Purchase.

3.02 Tuition Plan. The Purchaser shall select a Tuition Plan among the Tuition Plan options offered by KAPT, and payment of Value of a Prepaid Tuition Account shall be made by the Fund in accordance with the Tuition Plan and payment plan selected by the Purchaser.

3.03 Payment. Purchaser understands and agrees that payments by the Purchaser are due in the amounts and on the dates specified in the Purchaser’s Terms and Conditions of Payment and Purchase, and the Purchaser agrees to make full and complete payment to KAPT of the amounts indicated on the Purchaser’s Terms and Conditions of Payment and Purchase. Assessments and late payment fees shall be charged against the Purchaser’s Prepaid Tuition Account and payable by the Purchaser in accordance with KAPT Regulations. Payments due under this Agreement may be made by personal check, cashier’s check, or other certified cash equivalents. Payments may also be made by payroll deduction by the Purchaser’s employer. Non-cash contributions shall not be accepted by KAPT. This Agreement is not a debt instrument, nor shall KAPT extend credit to the Purchaser or anyone claiming benefits under this Agreement.

3.04 Default and Returned Items.

(a) Failure to make payment as required pursuant to a Purchaser’s Terms and Conditions of Payment and Purchase within 15 days shall constitute breach of this Agreement and result in the assessment of late payment fee(s). All rights of the Purchaser and Qualified Beneficiary under this Agreement may be terminated by KAPT upon such breach consistent with KAPT Regulations.

(b) A fee will be assessed for all returned payments in an amount published in KAPT Regulations.

3.05 Maintenance Fee. The Purchaser’s Prepaid Tuition Account under this Agreement shall be subject to such account maintenance fees as provided under KAPT Regulations.

ARTICLE IV BENEFITS

4.01 Contract Benefits. Payment of benefits under this Agreement shall be made in compliance with applicable KAPT Regulations.

(a) Subject to the fulfillment of all Purchaser’s obligations under

this Agreement, applicable law, and KAPT Regulations and consistent with Section 4.01 (c), this Agreement constitutes an irrevocable pledge and guarantee by the Fund to pay the Tuition of a Qualified Beneficiary upon acceptance and enrollment at an Eligible Educational Institution in accordance with the Tuition Plan purchased by the Purchaser.

(b) The Fund shall pay Tuition to the Eligible Educational Institution on behalf of the Qualified Beneficiary upon submission of sufficient documentation, as determined by KAPT in its sole discretion, to KAPT indicating admission of the Qualified Beneficiary at an Eligible Educational Institution in the Purchaser's Tuition Plan. Payment of benefits shall not begin prior to the second anniversary of the Purchaser's first payment due date under the Agreement.

(c) Under a Tuition Plan for private colleges and universities, Tuition shall be paid based on the same percentage that University of Kentucky tuition is increased from the year the Agreement is purchased to the year of payment.

(d) Upon enrollment of the Qualified Beneficiary at an Eligible Educational Institution, no refunds of any Tuition paid by the Fund will be made for any such academic term.

4.02 Full-Time Tuition. A Qualified Beneficiary attending an Eligible Educational Institution may apply the Value of a Prepaid Tuition Account in accordance with the Tuition Plan selected by the Purchaser, to a specific Academic Year at such Eligible Educational Institution.

4.03 Additional Fees. Purchaser understands and is aware that postsecondary institutions may charge fees not covered under this Agreement as a Tuition expense or mandatory fee. The Qualified Beneficiary shall bear any cost of additional fees, which may include, without limitation, health and activity fees, laboratory fees, transportation fees, academic program fees, and orientation fees.

4.04 Statements and Accounting. The Purchaser shall receive an annual statement from KAPT indicating amounts paid to KAPT and such other information as may be determined necessary by the Office. Payments made for Prepaid Tuition shall be accounted for separately for the Qualified Beneficiary.

4.05 Limitations. Nothing in this Agreement shall be construed as an express or implied promise or guarantee that a Qualified Beneficiary shall (i) be admitted to an Eligible Educational Institution, (ii) be allowed to continue to attend an Eligible Educational Institution after admission, or (iii) be graduated

from an Eligible Educational Institution.

4.06 Non-Participating Institutions. If the Qualified Beneficiary attends an Eligible Educational Institution for which payment of Tuition is not guaranteed by the Fund, in whole or in part, and if the cost of Tuition exceeds the Value of a Prepaid Tuition Account, the Fund shall have no responsibility to pay the difference. Payment in accordance with this Section shall be made after delivery to KAPT of records showing the Qualified Beneficiary's acceptance by and enrollment in such institution. If the Value of a Prepaid Tuition Account exceeds the cost of Tuition, the excess may be used for other Qualified Postsecondary Education Expenses as directed by the Purchaser.

ARTICLE V MODIFICATIONS

5.01 Beneficiaries. The Purchaser may change his Qualified Beneficiary only in accordance with the provisions, terms, and conditions of KAPT Regulations and applicable requirements of 26 U.S.C. 529 and regulations thereunder. Any such change, in addition, shall be made in writing by the Purchaser and submitted to KAPT; such change shall be made upon approval of KAPT and payment by the Purchaser of any related charges.

5.02 Tuition Plan. The Purchaser may request in writing to change the Academic Year(s) for which Prepaid Tuition is purchased, and the Purchaser may request to change his Tuition Plan. Any such change shall be implemented upon approval by KAPT and payment by the Purchaser of any related charges.

5.03 Purchaser. Any change in Purchaser, upon death, disability, marital dissolution, or otherwise, shall be made pursuant to this Section 5.03 and in accordance with applicable KAPT Regulations and 26 U.S.C. 529.

(a) The Purchaser may select a successor-in-interest in his Application in accordance with KAPT Regulations. Such successor Purchaser shall become the Purchaser in the event of the death or disability of the initial Purchaser and upon acceptance of this Agreement by the successor-in-interest. All rights and obligations of the initial Purchaser under this Agreement shall be transferred to such successor-in-interest in such case. Subsequent to submission of his Application, the Purchaser may designate (or modify) his successor-in-interest in such form and manner as determined by KAPT. Absent any such written designation accepted by the Office, this Agreement shall be assigned to the Purchaser's surviving spouse in the event of the Purchaser's death.

(b) Except as specifically provided herein, this Agreement may not be assigned or transferred, nor may any interest, right, or benefit of this

Agreement be assigned or transferred.

5.04 Change in Payment Method and Schedule. Request for a change in payment method or schedule must be submitted in writing by the Purchaser and approved by KAPT. Changes in payment schedule shall incur such fees as identified in KAPT Regulations.

ARTICLE VI TERMINATION AND REFUND

6.01 Termination. This Agreement may be terminated at any time upon written request of the Purchaser received by KAPT in a manner consistent with applicable KAPT Regulations. Upon termination of the Agreement, the Purchaser shall be entitled to payment(s) in accordance with this Article VI. Refunds may be paid in installments as determined in the sole discretion of KAPT, and interest shall not accrue on the installment payments. KAPT may impose a fee upon termination of the Agreement and deduct such fee from the amount otherwise payable under this Agreement. All refunds paid shall be net of administrative fees.

6.02 Death/Disability. If this Agreement is terminated upon request of the Purchaser due to the death or disability of the Qualified Beneficiary, the Fund shall pay to the Purchaser the Value of the Prepaid Tuition Account as determined under this Agreement. For purposes of this Section 6.02, “disability” shall mean such disability of the Qualified Beneficiary which, in the opinion of the Office, would make attendance by the Qualified Beneficiary at an Eligible Educational Institution impossible or unreasonably burdensome.

6.03 Scholarship. If a Qualified Beneficiary is awarded a scholarship which covers Tuition payable under this Agreement, then the Purchaser may request a refund consisting of the Value of the Prepaid Tuition Account not to exceed the amount of the scholarship.

6.04 Voluntary Termination.

(a) Upon termination of this Agreement at the request of the Purchaser, the Fund shall pay to the Purchaser the Value of the Prepaid Tuition Account upon the Purchaser’s request made on or after July 1 of the initial projected year of enrollment of the Qualified Beneficiary.

(b) Upon termination of this Agreement at the request of the Purchaser, the Fund shall pay to the Purchaser the amounts paid on this Agreement if this Agreement is terminated and a request for refund is made before July 1 of the Qualified Beneficiary’s initial projected year of enrollment.

The Board may determine a rate of interest to accrue for payment under this Section 6.04(b).

6.05 Excess Value. The Value of a Prepaid Tuition Account remaining after Tuition is paid may be used for other Qualified Postsecondary Education Expenses under KAPT Regulations.

6.06 Fraud/Misrepresentation. If KAPT determines that the Purchaser or the Qualified Beneficiary has engaged in fraud or misrepresentation with respect to this Agreement, the Agreement may be terminated by KAPT. In the event of termination under this Section, the refund payable by the Fund shall be in an amount determined under this Article VI offset by any applicable fees and costs incurred by KAPT as a result of such fraud or misrepresentation.

ARTICLE VII ADMINISTRATIVE FEES

7.01 Fees. Administrative fees shall be assessed when an Application is submitted by the Purchaser and when changes are made by the Purchaser under this Agreement. The amount charged for any such fee and types of fees are subject to change upon approval of the Board.

7.02 Types of Fees. The Board may impose, assess, and charge against the Purchaser’s Prepaid Tuition Account or require payment of any of the following administrative fees, as same shall be published in KAPT Regulations:

- (a) Application fee.
- (b) Account maintenance fee.
- (c) Payment schedule change fee.
- (d) Document copying fee.
- (e) Late payment and default fee.
- (f) Termination fee.
- (g) Beneficiary/Purchaser change fee.
- (h) All other administrative fees published in KAPT Regulations.

ARTICLE VIII INVESTMENTS

8.01 Restrictions. Amounts paid by the Purchaser under this Agreement shall be invested upon direction of the Board, and the Purchaser and the Qualified Beneficiary shall not directly or indirectly or otherwise control the investment of the Prepaid Tuition Account or earnings on such Account.

8.02 Public Funds. Assets of the Fund shall constitute public funds of the

Commonwealth and may be invested in any instrument, obligation, security, or property which constitutes legal investments for the investment of public funds in the Commonwealth which are deemed most appropriate by the Board. The Fund may be pooled for investment purposes with any other investment of the Commonwealth which is eligible for such asset pooling. Income earned from investment of the Fund shall remain in the Fund and shall be credited to KAPT.

ARTICLE IX REPRESENTATIONS OF PURCHASER

9.01 Representations.

(a) The Purchaser represents and certifies to KAPT that the Qualified Beneficiary is either (i) a resident of Kentucky at the time the Purchaser enters this Agreement or (ii) a non-resident who intends to attend an Eligible Educational Institution in Kentucky.

(b) The Purchaser agrees that he has read and understood the Disclosure Statement, attached hereto, as currently in effect.

9.02 Indemnification. The Purchaser, on behalf of himself, the Qualified Beneficiary, and their heirs and successors, indemnifies and holds KAPT, the Commonwealth, the Fund, its Board, KHEAA, their officers, agents, and employees harmless from and against any claim, loss, damage, liability or expense, including without limitation, reasonable attorneys' fees, incurred by reason of, or in connection with, any misstatement or misrepresentation made by the Purchaser with respect to this Agreement and/or Purchaser's Application and breach by the Purchaser of any agreement, representation, or obligation hereunder. The provisions of this Section 9.02 shall survive termination of this Agreement for any reason whatsoever.

9.03 No Commonwealth Liability. The Purchaser, on behalf of himself, the Qualified Beneficiary, and their heirs and successors, understands and acknowledges that (a) only assets of the Fund are available to guarantee the contractual obligations to the Purchaser and Qualified Beneficiary, (b) this Agreement does not obligate the general revenue or any other fund of the Commonwealth, nor does it obligate KHEAA or any public institution (c) this Agreement shall not be considered a debt or liability of the Commonwealth or KHEAA and neither the credit nor the taxing power of the Commonwealth are pledged to paying benefits hereunder, and (d) this Agreement does not constitute a pledge of the full faith and credit of the Commonwealth. Under KRS 393.015, 75 percent of the balance of the abandoned property fund administered by the Kentucky State Treasurer is available to meet any unfunded liability of the Fund, as may be determined by the Board.

9.04 UTMA Property.

(a) A Purchaser who is a custodian for a minor Beneficiary under applicable Uniform Transfers to Minors Act ("UTMA") or Uniform Gifts to Minors Act ("UGMA") (UTMA and UGMA referred to jointly herein as UTMA) may purchase a Prepaid Tuition Contract with UTMA custodial property consistent with the provisions of this Agreement. The Purchaser acknowledges that the Prepaid Tuition Contract shall represent UTMA custodial property and shall not constitute any individual asset of the Fund. The Purchaser acknowledges that he has full power and authority to act as UTMA custodian. The Purchaser shall at all times act in accordance with, and direct KAPT in a manner which is consistent with, applicable UTMA law. Further, the Purchaser and Beneficiary acknowledge and agree that KAPT shall not be considered to be, or act as, a UTMA custodian with respect to a Prepaid Tuition Contract purchased by a UTMA custodian.

(b) The Purchaser shall notify KAPT when the Beneficiary reaches the age of majority or otherwise is legally authorized to direct KAPT. The Purchaser acknowledges that at such time the Beneficiary shall be entitled to request withdrawals and direct payments from the Prepaid Tuition Account and to act as the Purchaser with respect to such account.

(c) At all times and under all circumstances, KAPT shall act at the direction of the Purchaser; and KAPT shall be under no obligation to ascertain or determine if any such action of a Purchaser is consistent with applicable UTMA law. Neither KAPT, nor the Board, the Fund, KHEAA, their officers, the Office, or the Commonwealth shall be liable to any person under UTMA law due to any action of, or failure to act by, the Purchaser with respect to a Prepaid Tuition Contract, specifically without limitation, the Purchaser's failure to act consistent with a standard of care required by UTMA, a change to another Beneficiary, or failure to transfer the Prepaid Tuition Contract to the Beneficiary at his/her age of majority. Purchaser shall hold KAPT and KHEAA harmless from any liability arising from any improper use or transfer of UTMA custodial property and any loss resulting from KAPT's reliance on the Purchaser's instructions with respect to the Prepaid Tuition Contract.

ARTICLE X MISCELLANEOUS

10.01 Term. This Agreement shall have a term commencing upon KAPT's acceptance of the Purchaser's Application and receipt of Purchaser's initial payment in accordance with his Terms and Conditions of Payment and Purchase, and ending on the earliest of (i) the Fund's complete payment of the Value of a Prepaid Tuition Account under this Agreement, (ii) action of the

Commonwealth to discontinue KAPT, or (iii) termination in accordance with the provisions of Article VI hereof.

10.02 Notices. All notices, changes, and elections made under this Agreement shall be in writing signed by the Purchaser and received by KAPT at the address designated by KAPT, together with any supporting materials which KAPT may request, and shall be sent to the Purchaser's current address recorded by KAPT.

10.03 Interpretation and Construction.

(a) This Agreement shall be interpreted and construed under the laws of the Commonwealth.

(b) Any words herein used in the masculine or neuter shall read and be construed in the feminine, masculine, or neuter where they would so apply. Words in the singular shall be read and construed as though used in the plural in all cases where they would so apply.

(c) Titles of Articles and headings to Sections are inserted for convenience of reference only and, in the event of any conflict, the text of this Agreement, rather than such titles and headings, shall control.

10.04 Severability. In the event that any clause or portion of this Agreement is found to be invalid or unenforceable by a court of competent jurisdiction within the Commonwealth, such clause or portion shall be severed from this Agreement, and the remainder of this Agreement shall remain in full force and effect.

10.05 Non-Attachment. This Agreement, the Prepaid Tuition Account, and rights and interests hereunder shall not be subject to attachment, levy, or execution by any creditor of the Purchaser or the Qualified Beneficiary. No interest or earnings on this Agreement shall be pledged or otherwise encumbered as security of a debt.

10.06 Claims Procedure. The Purchaser, the Qualified Beneficiary, or any related party must request review of any decision affecting said party in a manner consistent with KAPT's grievance procedure as provided in KAPT Regulations. Any legal action which arises pursuant to this Agreement shall be commenced in the courts of the Commonwealth following exhaustion of administrative remedies under KAPT Regulations.

10.07 Limited Liability. Any claim by the Purchaser or the Qualified Beneficiary pursuant to this Agreement shall be made solely against the assets of

the Fund. No recourse shall be had by the Purchaser, the Qualified Beneficiary, or any other party against the Board, KAPT, KHEAA, their officers, agents, or employees or against the Commonwealth in connection with any right or obligation arising out of this Agreement.

10.08 Promulgation and Amendment of KAPT Regulations. Purchaser understands and agrees that, in consideration for the benefits afforded under the KAPT program, changes to this Agreement may be necessary to assure the program's compliance with 26 U.S.C. 529 and related regulations and to receive favorable Kentucky state income tax treatment. In such event, the Purchaser authorizes KAPT to amend this Agreement to the extent necessary to obtain federal and state income tax benefits. Accordingly, the Board, on behalf of KAPT, shall promulgate such other Regulations and procedures and shall amend such KAPT Regulations as deemed appropriate or necessary by the Board to maintain compliance with 26 U.S.C. 529 and Kentucky law. Amendments to Regulations and procedures shall be incorporated into this Agreement, and the Purchaser and the Qualified Beneficiary shall be subject to all such amendments. Amendments to this Agreement shall be made with retroactive effect to the extent necessary to assure compliance with applicable state or federal law or regulations or to preserve favorable tax treatment of the KAPT program.

10.09 Prior Contract. This Agreement supersedes in its entirety and replaces all prior Master Agreements between the Purchaser and KAPT.

10.10 Successors and Assigns/Third Party Beneficiary. This Agreement shall survive the Purchaser's death and shall be binding upon the Purchaser's personal representatives, heirs, successors, and assigns.



Jonathan Miller, Kentucky State Treasurer
Chairman, Kentucky's Affordable Prepaid Tuition

KAPT DISCLOSURE STATEMENT

FOR FALL 2004 ENROLLMENT PERIOD
AUGUST 23, 2004, TO DECEMBER 13, 2004

See the KAPT website, www.getKAPT.com, for additional information.

This Disclosure Statement summarizes the provisions relating to the purchase of prepaid tuition contracts from the Commonwealth Postsecondary Education Prepaid Tuition Trust Fund (“Fund”) which is marketed under the name Kentucky’s Affordable Prepaid Tuition or (“KAPT”), a public instrumentality of the Commonwealth of Kentucky (the “Commonwealth”). This Disclosure Statement is provided in connection with the enrollment period identified above. KAPT has been established to assist purchasers to pay for tuition at Kentucky postsecondary educational institutions on a tax-advantaged basis. The purposes of the Fund are: (1) to provide affordable access to participating postsecondary educational institutions for qualified beneficiaries and (2) to provide students and their parents economic protection against rising tuition costs.

Purchasers are strongly urged to read this Disclosure Statement before purchasing a KAPT prepaid tuition contract. This Disclosure Statement is not intended to be a definitive or comprehensive statement of the terms and conditions of a KAPT prepaid tuition contract, and this Disclosure Statement is not part of the contract. Each statement herein is subject to qualification in its entirety by the terms and conditions of the KAPT Master Agreement, KAPT regulations, and applicable federal and state law.

You should consult your own tax and legal advisors before purchasing a KAPT Contract. This Disclosure Statement should not be considered legal advice; it does not take into account the individual tax or financial circumstances of a prospective purchaser.

SECURITIES LAW

KAPT Contracts have not been registered with the U.S. Securities and Exchange Commission or with any state securities commission. Neither the U.S. Securities and Exchange Commission nor any state securities commission has approved or disapproved KAPT Contracts or reviewed or approved this Disclosure Statement. This Disclosure Statement does not constitute an offer to sell, or a solicitation of an offer to buy, a security.

KAPT Contracts are not bank deposits or savings accounts, and they are

not insured by the Federal Deposit Insurance Corporation (FDIC), any governmental unit, insurance company, private person, or the Commonwealth. Under Kentucky Revised Statutes (“KRS”) 393.015, 75 percent of the balance of the abandoned property fund administered by the Kentucky State Treasurer would be available in the event of any unfunded liability of the Fund, as may be determined by the KAPT Board. KAPT Contracts are not debts or obligations of, nor are they guaranteed by, the federal government, the Commonwealth, or any bank or financial institution.

Information contained in this Disclosure Statement, Enrollment Booklet, KAPT’s website, Welcome Kit, and Master Agreement comprises the only information authorized by KAPT for a purchaser’s review regarding KAPT Contracts. Purchasers should also review KAPT regulations published at 11 KAR 17:010 to 11 KAR 17:110 which may be viewed at the KAPT website. Purchasers should consult a tax consultant or advisor regarding acquisition of a KAPT Contract and corresponding availability for KAPT benefits. No one is authorized to provide information regarding KAPT which is different from the information contained in this Disclosure Statement and the KAPT Welcome Kit.

In order to purchase prepaid tuition credits for the fall 2004 enrollment period, you must submit an application between August 23, 2004, and December 13, 2004. Applications to join KAPT are available by request to the KAPT Headquarters, KHEAA, P.O. Box 798, Frankfort, Kentucky 40602; by calling 1-888-919-KAPT; or by visiting www.getKAPT.com.

This Disclosure Statement presents only a summary of the features of the KAPT program. The legal terms and conditions for payment of benefits are governed by the Master Agreement, applicable Kentucky law, and KAPT regulations published at 11 KAR 17:010 to 11 KAR 17:110. A KAPT prepaid tuition contract consists of the purchaser’s application, Master Agreement, Terms and Conditions of Payment and Purchase, KAPT regulations, and applicable federal and state law (collectively, the “KAPT Contract”). All benefits payable under the KAPT program will be made in accordance with the purchaser’s KAPT Contract. You should carefully read these legal documents in addition to this Disclosure Statement because they create binding legal obligations.

The terms and features of KAPT in subsequent enrollment periods may differ from the terms and features described in this Disclosure Statement. There is no assurance that additional enrollment periods will take place. In addition, the KAPT Board (“Board”) may limit the number of purchasers who may join the KAPT program in any given enrollment period.

For purposes of this Disclosure Statement, the following terms shall be defined as follows: Participating individuals in the KAPT program who purchase a KAPT Contract are “purchasers.” Each KAPT Contract has a single beneficiary selected by the purchaser, the “beneficiary.”

THE FUND.

The Kentucky General Assembly created the Fund during its 2000 regular session, and the Fund is governed under KRS 164A.700-164A.709 and 393.015.

The Fund is governed by an 11-member Board, consisting of five members who hold state office, three members appointed by the Kentucky Treasurer, and three members appointed by the Governor of Kentucky. The state ex-officio members include the State Treasurer, who also acts as Chairman of the Board; the Secretary of the Kentucky Finance and Administration Cabinet; the Chair of the Association of Independent Kentucky Colleges and Universities; and the President of the Kentucky Council on Postsecondary Education. The Executive Director of the Kentucky Higher Education Assistance Authority acts as a non-voting member of the Board. Under Kentucky law, the members of the Board must have experience in finance, accounting, and investment management. Members of the Board receive no compensation but are reimbursed for actual expenses incurred in the performance of their Board duties. KAPT is administered by the Kentucky Higher Education Assistance Authority (KHEAA). KHEAA is a Kentucky State Government Agency that administers scholarships, grants, work-study, savings, and Federal Family Education Loans for higher education. For more information about KHEAA, visit www.kheaa.com. KAPT’s Executive Director is responsible for the daily administration and operations of the KAPT program.

For information about the Fund’s recordkeeper, investment manager, investment consultant, and actuary, please-call 1-888-919-KAPT, option 3.

PROGRAM RISKS.

The following is a list of some of the factors, risks, and contingencies which purchasers should consider before purchasing a KAPT Contract.

Long-Term Investment. The purchase of a KAPT Contract is a long-term investment. Under the program if a contract is voluntarily terminated by the purchaser prior to July 1 of the beneficiary’s initial projected year of enrollment, the purchaser may receive a refund only in the amounts actually paid for the KAPT Contract. Generally, no payment is made by the Fund until a beneficiary enrolls in a postsecondary institution. Also, KAPT may pay any

refund in installments, meaning that a purchaser would not have immediate access to a cash refund.

Purchasers and beneficiaries are not entitled to receive a benefit from any investment returns of the Fund which exceed the Fund’s obligations to pay prepaid tuition. Future Fund tuition obligations are established by calculating estimated future Kentucky tuition costs based on current costs and actuarial and investment performance assumptions. These projections are used to determine the prices for KAPT tuition plans. In the event one or more of the underlying assumptions proves to be inaccurate, the Fund may be unable to perform its obligations under the KAPT Contracts. Importantly, one of the primary factors affecting the Fund’s ability to satisfy its obligations under KAPT Contracts is the Fund’s attainment of a sufficient return on its investments.

The Fund’s current investment policies provide for a targeted total rate of return based on an actuarial determination of the rate of return which is needed to enable the Fund to meet its obligations given current KAPT Contract pricing and projected enrollment dates. KAPT makes no representation, express or implied, or any assurance or guarantee that future investment returns will equal or exceed targeted investment returns established by the Board. If the investment return of the Fund’s assets were to fall short of its targeted level for a sustained period of time, the Fund’s ability to perform its contract obligations could be significantly impaired. An important additional consideration is that pursuant to KRS 393.015, 75 percent of the abandoned property fund administered by the Kentucky State Treasurer would be available to meet any unfunded liability of the Fund, as may be determined by the Board.

No Guarantee of Admission. KAPT provides no assistance and makes no representation or guarantee, express or implied, to a beneficiary with respect to admission, continued enrollment at, or graduation from a college or university. KAPT’s benefits are limited to the Fund’s payment of tuition and mandatory fees as described in the purchaser’s KAPT Contract. Purchase of a KAPT Contract does not guarantee college admission, continued enrollment, or graduation, or that a student will qualify for in-state tuition rates at a particular postsecondary institution. Finally, if a beneficiary does not attend a postsecondary educational institution and the KAPT Contract is not transferred to a family member (see discussion below), then full contract benefits may not be available.

Limited Substitution of Beneficiaries. If the beneficiary designated on the purchaser’s application does not attend a postsecondary educational institution, the purchaser may be eligible to substitute another beneficiary according to KAPT regulations (see discussion below). However, substitution of a beneficiary whose projected enrollment date is later than that of the initial benefi-

ciary will not result in any refund of contract payments or earnings realized by the Fund in respect of such payments. A purchaser may request substitution of a beneficiary with a projected enrollment date which is earlier than the initial projected enrollment date; in such case, the purchaser may be required to pay additional amounts resulting from a change in enrollment date to properly fund the amended contract.

Lack of Contract Transferability. KAPT Contracts may not be resold under any circumstances. A purchaser may transfer funds from his prepaid tuition account to another qualified tuition program under Code Section 529 in accordance with KAPT regulations. The Fund makes no representation, express or implied, that a purchaser will be able to transfer his Contract.

BUYING TUITION BENEFITS.

To purchase KAPT prepaid tuition benefits, you must file an application with KAPT during an open enrollment period. Individuals may participate in KAPT regardless of income level or age, and KAPT is open to purchasers wherever they reside. Individuals, trusts, corporations, partnerships and other legal entities may purchase contracts; Uniform Transfers to Minors Act (UTMA) accounts may also be used to fund the purchase of KAPT benefits. A purchaser does not have to be related to the beneficiary. There may only be one purchaser, and the purchaser may make changes to or cancel the contract only in accordance with the purchaser's KAPT Contract.

Payments to KAPT may be made by the purchaser or any other person; all payments by someone other than the purchaser become the property of the Fund subject to the terms of the KAPT Contract regardless of the relationship to the purchaser or identity of the contributor. KAPT benefits may only be used to fund the tuition costs for one beneficiary of the prepaid tuition account. The initial beneficiary must be selected by the purchaser on his application.

A purchaser's application will be accepted or denied by KAPT based upon conditions set forth in KAPT regulations. A non-refundable application processing fee of \$50 must accompany the application. Only payments in cash equivalents may be made by the purchaser, and in certain cases payroll deduction may be available for payment to KAPT. The beneficiary must be a resident of Kentucky at the time the contract is purchased, or if a beneficiary is a nonresident, the purchaser must indicate on his application that the nonresident beneficiary intends to attend an eligible educational institution in Kentucky. Finally, the beneficiary's proposed enrollment date must be no sooner than two years from the first payment due date of the contract.

The price for prepaid tuition benefits charged by KAPT for an open

enrollment period is determined actuarially. Pursuant to Kentucky law, the Board is required to obtain actuarial assistance in order to establish, maintain, and certify funds sufficient to defray the obligations of the Fund. This actuarial determination is to be completed annually. After the actuarial evaluation is completed, the Board determines, based on such actuarial valuation, the purchase price of KAPT Contracts charged during an open enrollment period to ensure the actuarial soundness of the Fund. Based upon the Fund's annual actuarial valuation and increases in tuition and mandatory fees at applicable institutions together with investment performance of the KAPT Fund, the Board may adjust the price of KAPT Contracts for subsequent open enrollment periods in order to maintain the actuarial soundness of the Fund.

CONTRACT BENEFITS.

KAPT Contracts are designed, primarily, for the purpose of prepaying in-state rates of undergraduate tuition and mandatory fees at two- and four-year public institutions of higher education in Kentucky (Kentucky Public Institutions) as identified in the Value and Standard Plans. KAPT Contracts create an obligation of the Fund to pay a beneficiary's in-state undergraduate tuition and all mandatory fees required as a condition of full-time enrollment at any Kentucky Public Institution for the specified number of academic terms purchased under the Value Plan or the Standard Plan. Full-time enrollment is defined as 16 semester hours for purposes of calculating the value of a prepaid tuition account. When the full purchase price has been paid and the qualified beneficiary has enrolled, the Fund is contractually committed to pay the tuition costs for full-time enrollment and mandatory fees of the beneficiary. In other words, the tuition cost guarantee may be purchased by selecting either the Value Plan or the Standard Plan.

Mandatory fees are those fees required as a condition of enrollment of all students for full-time enrollment in an undergraduate program. Unless a purchaser has excess tuition benefits (explained below), the Fund does not cover any other costs or fees that a student is obligated to pay; for example, mandatory fees do not include individual fees related to participation in a particular sport or activity, individual course fees such as laboratory fees or special academic program fees, books, or room and board. Payment options, features, and the list of Kentucky Public Institutions under the Value Plan and Standard Plan are included in KAPT's Enrollment Booklet.

The Premium Plan aims to help families cover the average cost of tuition at Kentucky private, accredited colleges and universities (Kentucky Private Institutions). Under the Premium Plan, KAPT's payment of tuition is based on the annual rates of increase in tuition costs at the University of Kentucky—not actual tuition costs at a private institution—and KAPT does

not guarantee payment to cover full tuition at a private institution under the Premium Plan. A beneficiary who attends an educational institution other than a Kentucky Public Institution is responsible for paying the amount by which his actual tuition cost exceeds the amount of the value of his prepaid tuition account. **Importantly, the Fund does not guarantee full payment of tuition at any Kentucky Private Institution.** Also, a beneficiary who attends a Kentucky Public Institution but who does not qualify for the in-state tuition rate is responsible for paying the amount by which the out-of-state tuition cost exceeds in-state tuition. For more details and payment options, please refer to the KAPT Enrollment Booklet.

If not used for Kentucky institutions, Contract benefits may be used toward the cost of tuition and qualified higher education expenses if a qualified beneficiary attends an out-of-state postsecondary educational institution. In addition, if the value of a purchaser's prepaid tuition account exceeds the actual costs of tuition and mandatory fees, then such unused tuition benefits may be applied for payment of other qualified higher education expenses, including graduate school tuition and fees. Qualified higher education expenses include tuition, fees, books, supplies, and equipment required for enrollment as well as room and board if the beneficiary is enrolled at least half time. Payments for tuition and mandatory fees are made directly to eligible educational institutions.

The value of KAPT prepaid tuition benefits is not used in calculating personal asset contribution for determining eligibility and need for student loan programs, student grant programs, or other student aid programs administered by any agency of the Commonwealth, except as otherwise may be provided under federal law. For federal need-based financial aid, the receipt of KAPT Contract benefits is currently treated as a financial resource of the beneficiary and may affect a beneficiary's eligibility for financial aid.

SUBSTITUTION OF BENEFICIARY, CHANGES TO TUITION PLAN, AND TRANSFER OF CONTRACT RIGHTS.

Purchasers may change their beneficiary designation consistent with Internal Revenue Code Section 529 (26 U.S.C. 529). For example, under current Tax Code requirements, the new beneficiary must be a member of the family of the original beneficiary. Purchasers should carefully review applicable tax rules regarding changes of a beneficiary. In addition, as provided in the Master Agreement, a purchaser may change from one KAPT tuition plan to another, and in limited circumstances and with the approval of KAPT, KAPT Contract rights may be transferred in the event of a purchaser's death, disability, or marital dissolution. Finally, a purchaser may request transfer of his prepaid tuition account to another qualified tuition program; any such transfer will be

made in accordance with 26 U.S.C. 529 and KAPT regulations. For more detailed information concerning substitution, transfer, and conversion, please see the Master Agreement and applicable KAPT regulations.

FUNDING AND ACTUARIAL ASSUMPTIONS.

KAPT's funding is derived from contract purchasers and the investment income earned by the Fund. Interest and income earned from the investment of such funds remain in and are credited to the Fund. The Board has engaged a third-party investment manager to invest and manage the Fund. Assets of the Fund constitute public funds and may be invested in any security which constitutes legal investments of public funds. No purchaser or beneficiary may direct the investment of any contributions to the Fund or related earnings. Any favorable investment results accrue to KAPT and do not result in a direct benefit to purchasers or beneficiaries or increase in the value of their prepaid tuition accounts or a refund of payments. The Fund's investment purpose is to seek to earn rates of return that exceed anticipated tuition inflation rates so that the Fund meets its obligations to pay prepaid tuition in future years. KAPT Contracts do not obligate any general revenue of the Commonwealth and are not backed by the full faith and credit of the Commonwealth. However, 75 percent of the balance of the abandoned property fund administered by the Kentucky State Treasurer would be available to meet any unfunded liability of the Fund, as may be determined by the Board.

UTMA ACCOUNTS.

Under the Kentucky Uniform Transfers to Minors Act (UTMA), a person may make an irrevocable transfer to a minor beneficiary, and the transferor retains control of transferred custodial property—subject to a standard of care under UTMA—until the minor beneficiary attains age of majority, age 18 in Kentucky. KAPT will accept UTMA funds or funds under other states' laws (sometimes referred to as Uniform Gifts to Minors Act or "UGMA" accounts) for purchase of a KAPT Contract. UTMA/UGMA accounts involve additional restrictions and obligations which do not apply to other KAPT Contracts. If you are considering using a UTMA/UGMA account for such purchase, you should consult your legal advisor to determine if applicable state law permits use of UTMA/UGMA accounts for this purpose and to discuss your ongoing responsibilities under UTMA/UGMA following purchase of a KAPT Contract.

Under Kentucky law, a UTMA transfer is an indefeasible gift to the minor beneficiary, and following transfer the transferor is considered the UTMA custodian for purposes of UTMA law and for use of KAPT Contract benefits. The UTMA custodian, further, remains subject to a standard of care under UTMA

in dealing with a KAPT Contract. Under Kentucky law, a UTMA custodian must transfer custodial property to the beneficiary upon attainment of age 18. In effect, this means that all rights under the KAPT Contract, including the ability to request a refund, would become exercisable, without restriction, by the KAPT beneficiary at age 18.

Typically, UTMA/UGMA accounts are subject to the following additional requirements and restrictions:

- The UTMA/UGMA custodian is permitted to withdraw funds only in accordance with applicable UTMA/UGMA law.
- The custodian may not change a beneficiary except in a manner consistent with UTMA/UGMA.
- The custodian may not designate a successor purchaser, unless in accordance with UTMA/UGMA.

KAPT shall not be liable to any purchaser, beneficiary, or third party for any breach or violation of applicable UTMA/UGMA, nor shall KAPT be responsible for, or obligated to ascertain whether, any direction given to KAPT by the purchaser complies with UTMA/UGMA. Compliance with UTMA/UGMA is solely the responsibility of the purchaser. KAPT strongly urges you, if you are considering UTMA funds for purchase of a KAPT Contract, to review these matters and properly assess your legal obligations and your beneficiary's rights under UTMA/UGMA law.

TAX CONSIDERATIONS.

The following is a summary of certain federal income, gift, and estate tax consequences relating to the KAPT program with respect to a purchaser's payments to KAPT; Fund earnings and distributions from the Fund to eligible educational institutions; and in certain circumstances, to participants. This summary is not exhaustive of all potential tax consequences and is not intended as individual tax advice to any purchaser, beneficiary, or any other person. Applicable tax rules under federal and state law are complex, and certain rules are uncertain at present. Application of the tax rules may vary according to an individual's particular facts and circumstances. KAPT makes no representation or assurance, express or implied, that the Internal Revenue Service (IRS) or the Kentucky Revenue Department will accept the particular conclusions expressed in this summary.

You should consult a qualified tax advisor for questions about how the tax laws may affect your individual tax situation.

KAPT was established, in part, to obtain federal income tax benefits provided under Internal Revenue Code Section 529 (26 U.S.C. 529). 26 U.S.C. 529 governs the federal tax treatment of qualified tuition programs and the tax consequences for purchasers and beneficiaries of such plans.

This summary is based on relevant provisions of 26 U.S.C. 529 in effect as of August 1, 2004. The U.S. Congress, the Treasury Department, the IRS, and state taxing authorities may take actions which would adversely affect the tax consequences described herein, and any such adverse effects may be retroactive. Final tax regulations concerning qualified tuition programs under 26 U.S.C. 529 have not been issued by the IRS, and if issued by the IRS, such final regulations may alter the tax consequences summarized in this Disclosure Statement.

KAPT has been designed and intends to be maintained as a "qualified tuition program" under 26 U.S.C. 529 to permit purchasers and their beneficiaries to qualify for federal and state tax benefits applicable to such programs. Federal income tax benefits applicable to qualified tuition programs include:

- (1) The program fund is exempt from federal income tax;
- (2) Earnings of the program fund with respect to a purchaser's prepaid tuition account are not includible in the taxable income of the purchaser or beneficiary; and
- (3) Amounts paid by the program fund to pay qualified higher education expenses of the beneficiary are not includible in taxable income.

In order to achieve these tax benefits, a prepaid tuition program must satisfy the conditions of 26 U.S.C. 529, namely:

- Purchases may only be made in cash;
- The program must provide separate accounting for each beneficiary;
- Purchasers and beneficiaries may not, directly or indirectly, direct investment of any contributions to the prepaid program (or earnings);
- Interests in the program may not be used as security for a loan; and
- The program must provide adequate safeguards to prevent contributions on behalf of a beneficiary in excess of the amount necessary to provide for qualified higher education expenses of the beneficiary.

Your KAPT account is comprised of two components: your contributions and the increase in tuition value over your contributions, referred to as “earnings.” The part of any KAPT distribution which represents your contributions is not taxable. The amount paid in excess of your contributions, generally, will not be taxable to the purchaser or beneficiary as long as withdrawals are used for the beneficiary’s qualified higher education expenses.

You should retain receipts, invoices, or other documents and information adequate to substantiate that distributions from your prepaid tuition account were used for qualified higher education expenses because it is your responsibility to substantiate qualified higher education expenses.

Earnings not used for qualified higher education expenses must be included in the distributee’s taxable income. For example, refunds to a purchaser are subject to income tax to the extent distributions exceed the purchaser’s contributions. Also, there is an additional tax of 10% on any taxable distribution. In general, the additional 10% tax is imposed on earnings which are not used for a beneficiary’s qualified higher education expenses. Exceptions from the 10% tax include:

- (1) Payment to a beneficiary (or the estate of the designated beneficiary) on or after the death of the designated beneficiary;
- (2) Payment attributable to the beneficiary’s being disabled;
- (3) Payment made on account of scholarship, to the extent the amount of the payment does not exceed the amount of scholarship; and
- (4) Payment which is taxable only because the qualified education expenses were taken into account in determining the Hope or lifetime learning credit.

For more information about taxation of KAPT distributions, see IRS Publication 970 which is available at the IRS website, www.irs.gov.

Your participation in another qualified tuition program may impact (and in certain circumstances reduce) the tax benefits available under KAPT. Also, Tax Code rules coordinate your KAPT benefits with Coverdell (Education) IRAs and Hope and lifetime learning tax credits; please discuss the possible impact of your KAPT benefits with your tax advisor.

KAPT is required to report to the IRS payments of tuition, educational expenses, and refunds to purchasers. You should be aware that following such distribution, KAPT will forward Form 1099-Q to the IRS and the distributee

(purchaser or beneficiary, depending on distribution) for income tax reporting. The due date for filing Form 1099-Q is January 31 of the year following distribution. Form 1099-Q should be reviewed in preparation of the purchaser’s (or beneficiary’s) income tax return for the year of distribution from the KAPT program.

There are also important federal gift tax considerations under 26 U.S.C. 529. For example, payments to a qualified tuition program on behalf of a beneficiary are generally considered a completed gift for gift tax purposes. Since the purchase of a prepaid tuition account under a qualified tuition program is considered a completed gift, purchasers are potentially subject to federal gift tax depending on the amount of the gift. For instance, federal gift tax is not imposed on a purchaser for gifts to a beneficiary which do not exceed the annual gift tax exclusion amount with respect to such beneficiary (currently \$11,000, periodically adjusted for inflation); all gifts in a year to a single beneficiary are counted for this purpose. Purchasers should contact their tax advisor regarding any requirement to file gift tax returns with the IRS upon opening a KAPT account.

If a purchaser’s amount paid to a qualified tuition program together with other gifts to the same beneficiary in that year exceeds the annual gift tax exclusion amount, the purchaser may elect to treat prepaid tuition purchases up to \$55,000 as having been made ratably over the five-year period beginning with the tax year of purchase by filing a federal gift tax return for that year. That is, if purchase of prepaid tuition benefits by any one individual to a single beneficiary in a single tax year is greater than \$11,000 for 2004 (\$22,000 for married couples), the purchaser may elect to account for the aggregate amount, for purposes of the gift tax annual exclusion amount, ratably over the five-year period beginning with 2004. The purchaser should also be aware that his applicable lifetime gift tax credit (\$1 million) may be applied to taxable gifts in excess of the annual gift tax exclusion amount. Be sure to consult your tax advisor to determine if these gift tax rules apply to you.

26 U.S.C. 529 also provides that no amount is includible in the taxable estate of any individual by reason of an interest in a qualified tuition program. In other words, generally speaking, a prepaid tuition account under a qualified tuition program will not be subject to federal estate tax on the death of the purchaser; however, 26 U.S.C. 529 provides that this exclusion from estate tax does not apply to amounts distributed on account of the beneficiary’s death. Also, if a purchaser dies before the end of the five-year averaging period discussed above, the purchaser’s taxable estate would include the portion of the original payment that is allocable to the years following the purchaser’s death.

Neither 26 U.S.C. 529 nor IRS Proposed Regulations specifically address the tax consequences of a change in purchaser of a prepaid tuition account.

Purchasers and successor purchasers should consult their tax advisors regarding estate, gift, and income tax consequences resulting from such changes.

Kentucky Income Tax. KAPT prepaid tuition accounts are exempt from Kentucky income tax. If distributions of earnings are made for qualified higher education expenses, the value of a purchaser's prepaid tuition account will not be included in computing Kentucky income tax of a purchaser or beneficiary. Contributions are not deductible for Kentucky income tax purposes.

2001 TAX LAW.

The Economic Growth & Tax Relief Reconciliation Act of 2001 (EGTRRA) significantly enhanced tax benefits for 26 U.S.C. 529 qualified tuition programs. However, under EGTRRA, favorable tax provisions "sunset" or become ineffective after December 31, 2010, and become replaced with the law in effect prior to EGTRRA. EGTRRA results in tax-free qualified withdrawals for beneficiaries from prepaid tuition accounts; in contrast, under pre-EGTRRA law, prepaid tuition earnings paid from a qualified tuition program would be taxable to the purchaser's beneficiary upon payment of tuition. EGTRRA provisions became effective January 1, 2002. As a result, this tax issue merits careful consideration by each purchaser to determine how such legal changes and "sunset" provisions will impact each purchaser based on individual projected enrollment dates and any possible federal and Kentucky tax penalties.

The statements contained in this summary are for informational purposes only; KAPT makes no representation, express or implied, that purchasers or any other person should rely on this summary. Individual tax situations vary greatly, and KAPT cannot provide legal or tax advice. Payment of any tax liability is the responsibility of the purchaser or beneficiary and not KAPT. Please consult a tax advisor concerning the legal or tax implications resulting from the purchase of a KAPT Contract.

Information in this Disclosure Statement is subject to change without prior notice, and this Disclosure Statement may contain differences from previous Disclosure Statements delivered by KAPT to purchasers.

Please contact 1-888-919-KAPT if you have any questions or need further information about the KAPT program.

August 2004